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MEMORANDUM

Members of the VML/VACO Virginia Power Steering Committee

FROM: Louis R. Monacell, Esquire
Cliona M. Robb, Esquire

DATE July 6, 2001

New Seven-Year Contract Effective July 1, 2000/Major Areas of Change and Impact

We are pleased to report that we have reached agreement with Virginia Power on the form of a new seven-year contract for electric service to local governments to be effective from July 1, 2000 to June 30, 2007. We present this memorandum, together with assistance from your utility consultants, Steve Ruback and Jim Cotton of the Columbia Group, to summarize major areas of change and impact in the new seven-year contract for electric service. These major areas are outlined below.

Within the next few weeks, we will distribute a more detailed "how-to" memorandum with suggestions for implementing various aspects of the new agreement.

The documents that accompany this memorandum are as follows:

- Memorandum from the Executive Director of VML, the Executive Director of VACo, and the Chair of the VML/VACo Virginia Power Steering Committee
- Transmittal Letter from Virginia Power setting forth agreements made outside the scope of the contract documents
- Master Agreement marked to show how the new agreement changes the 1997 agreement
- Attachment A for rates effective July 1, 2000 to December 31, 2000 marked to show how these rates revise the 1997 rate schedules.

- o Attachment B for rates effective January 1, 2001 to June 30, 2007 marked to show how these rates revise the 1997 rate schedules.
- o Attachment C for terms and conditions marked to show how these terms and conditions change the terms and conditions in the 1997 agreement.
- o Attachment D for rate schedules and rules applicable to local government pilot program accounts

1. Rate Reduction for Tax Law Changes

The General Assembly enacted legislation that, effective January 1, 2001, eliminated gross receipts taxes on electric utility bills and imposed state income taxes for the first time on Virginia Power. (It also imposed a consumption tax for electricity for the first time on non-governmental customers.) While the negotiations with Virginia Power were relatively straightforward for eliminating the gross receipts tax (equal to approximately 2.6% of the monthly bill) and exclusion from the consumption tax, negotiations were required to resolve how much of the benefit of removing the gross receipts tax was to be offset by imposition of the state income tax. On January 1, 2001, Virginia Power lowered rates to local governments to reflect the tax law changes by $3,503,000 on an annual basis. We were responsible in the negotiations for increasing the annual savings to all local governments by on the order of $300,000 by negotiating for a lower income tax cost to be embedded in the base rates that are to be frozen by the contract. Over the life of the contract this benefit from our negotiations will save the local governments, we estimate, in excess of $2 million.

2. Rate Reduction Due to Reduced Allocation of Purchased Capacity

The local governments' rates include base rates and a fuel adjustment. Part of the fuel adjustment is an allocation of purchased capacity cost that are allocated to local governments based upon an allocation factor related to the local governments' usage as compared to usage of other types of customers served by the utility. We were successful in negotiating a lower allocation factor for the local governments than proposed by Virginia Power. This lower allocation should save all local governments annually on the order of $800,000 starting July 1, 2001 and continuing during the life of the contract in excess of $5 million.

3. Seven-Year Freeze of Base Rates

In the past, the local governments have generally contracted for three-year agreements with Virginia Power. In the negotiation for this contract, Virginia Power asserted and provided documentation to support a rate increase of $11 million per year. In contrast, the new agreement provides for no increase in base rates but rather caps base rates at the level of the prior contract generally, after the tax and purchased capacity reductions discussed above, during the remainder of the seven-year agreement. Because your base rates are capped for seven years, as opposed to three, you have the benefit of greater stability in your electric costs than you would have had with the prior shorter term contracts. The current monthly fuel adjustment will continue generally as in prior contracts.

4. **6-to-1 Streetlighting Ratio**

We were successful in continuing the benefit of a 6-to-1 ratio for streetlighting projects. This means that when Virginia Power makes an investment on a new streetlighting project for local governments it will generally give local governments a credit of six years' worth of revenue, minus the fuel adjustment, in determining whether a local government must make any up-front payment. The difference between a 6-to-1 and a 4-to-1 ratio, as would otherwise apply, is a savings to all local governments on the order of $2 million per year, which would be $14 million over the life of the contract.

5. **Grandfathered Standby Generator Credit**

We were successful also in continuing the grandfathering of the $75 annual credit for standby generation. This contrasts with the credit paid to Virginia Power's jurisdictional customers of $24 per kW per year. The grandfathering at the $75 level saves local governments in total on the order of $900,000 per year and over $6 million over the life of the contract. Moreover, the new contract clarifies that a local government with a grandfathered SG account has the right at the beginning of each summer or winter season to revert to its SG capacity at the grandafthered level of kW.

6. **Opening Up Schedule 132**

Prior to this contract, Schedule 132, which provides for variable time pricing and savings to local government accounts that can avoid usage during peak load "A days", was closed to existing accounts. The new agreement allows up to 100 existing accounts to switch to Schedule 132. We estimate that this could provide savings to local governments in total on the order of $1 million per year and over $7 million over the life of the contract.

7. **New Interval Metering**

Interval meters are meters that record usage during every hour. Presently, Virginia Power has installed interval meters generally only to accounts that have the capability of using 750 kW or more of demand. Pursuant to the new agreement, Virginia Power will install (with no cost to local governments during the contract) interval metering for all accounts with 500 kW or more of demand. We estimate that this saves the local governments in total in excess of $200,000 for the cost of such meters. Such interval meters will provide data that should make serving such accounts more attractive to competitive suppliers.

8. Pilot for Customer Choice

As part of the new contract, Virginia Power has agreed to a pilot program for local government accounts to select one or more competitive service providers for generation services for up to 117 million kWh of local government usage on an annualized basis. The Steering Committee has assisted in formation of a joint powers agreement association named the Virginia Governmental Electricity Purchasing Association, which will conduct a request for proposals in the near future for certain eligible accounts on Schedules 100, 110, and 130 with interval meters. Preparation for this pilot program will serve as a valuable "test run" for structuring a long term JPA to assist local governments in procuring generation services competitively.

9. Full Customer Choice

Pursuant to the contract, local governments are entitled to continue to receive full service from Virginia Power at the capped base rates through June 30, 2007. However, one-third of all local government accounts will have choice of their generation supplier starting January 1, 2002; an additional one-third on September 1, 2002, and all local government accounts on January 1, 2003. We are hopeful that this opportunity to select another supplier while having the option of staying with Virginia Power will save local governments in total in excess of $1 million per year and over $6 million during the life of the contract.

10. Capital Project Matters

We were successful in providing greater flexibility and clarification in matters related to capital projects. Virginia Power clarified when the use of company-approved contractors is not required, and agreed to provide assistance from upper level management when local Virginia Power personnel unreasonably prohibit localities from performing work that Virginia Power would otherwise subcontract. Virginia Power also clarified what parameters it uses in determining whether to add a contractor to its approved-contractor list, and provided a mechanism for local governments to request that a contractor be added. Virginia Power also specified the circumstances under which it may require minimum contract payments for new projects; previously, this had been done on an ad hoc basis with no restrictions on what Virginia Power could require.

Virginia Power also agreed to set up a joint action committee (JAC) with the overall objective of affecting positive changes in Virginia Power and local government procedures that will improve service to local governments. The JAC will be staffed by representatives of the Steering Committee and Virginia Power personnel with the authority to implement changes recommended by the JAC. Topics to be addressed by the JAC include cost estimates, cost overruns, and construction scheduling issues.

11. Billing and Payment Matters

We were successful in negotiating certain clarifications and improvements for billing and payment matters. The JAC will address problems related to monthly billing adjustments for streetlights. Virginia Power has agreed to make senior management available to discuss problems related to improper posting of payments, misdirection of bills, and related matters. In addition, Virginia Power has agreed to extend its billing adjustment period to three years (previously, the adjustment period was one year) and has agreed to permit the use of electronic billing OR electronic payment (previously, these were only offered as a package deal).

12. Streetlighting Matters

We were successful in negotiating certain clarifications and improvements related to streetlighting outages and repairs. The JAC will address issues related to the adequate and timely maintenance of streetlights. The streetlighting website will be opened up to all localities for reporting and tracking streetlighting outages; outages called into Virginia Power's 800 number will be added to the website, and localities will still be able to call in unusual outage situations directly to Virginia Power. Virginia Power has agreed to address comprehensively problems encountered with the use of its website to date. The repair times and billing adjustments for streetlights have been altered to address concerns about Virginia Power's position that it had an unlimited amount of time to repair outages involving underground cables, and that no billing adjustments were required in these circumstances. Time frames have now been imposed on all outages involving cable repairs, and the types of outages to which minimum repair times apply have been expanded slightly.

13. Contract Re-openers

We were successful in limiting the contract re-openers that Virginia Power initially proposed for a seven-year contract. We limited rate adjustment for financial distress to circumstances where the State Corporation Commission has made a finding that Virginia Power is subject to financial distress beyond its control. All other contract re-openers may revise the agreement only if the Steering Committee consents to the revision, and the parameters for good faith renegotiations are fairly reasonable. For instance, when Virginia Power transfers its generation assets, any revisions related to this transfer will be designed not to cause customers to pay more for fuel, purchased power, and non-fuel rates that they would have paid under the current fuel adjustment provisions if ownership had not been transferred. Similarly, a contract re-opener for revising the calculation of line extension payments (i.e. to exclude generation payments in calculating the 4:1 or 6:1 ratio) will only be done after the State Corporation Commission has approved this change for jurisdictional customers while preserving (to the extent feasible) any unique characteristics of the line extension policies for local governments.

14. Supplemental Agreements

The "contract" portion of the new agreement (which contains the signature lines) states that the new agreement will cancel all previous agreements with Virginia Power unless otherwise agreed to in writing. This cancellation provision does not apply to any agreement for minimum contract amounts that is entered into prior to July 1, 2001. Section VII. G of the Terms and Conditions, which contains new minimum contract provisions, states that any agreement for minimum contract amounts that is entered into prior to July 1, 2001 will remain in place until such time in the normal course of business that such minimum contract provision is to be modified.

If a locality has supplemental agreements for electric service other than those setting forth minimum contract amounts, then each locality should review such existing agreements and determine whether it is in the locality's interest to have the agreement remain in place. If it is in the locality's interest to have the agreement remain in place, then the locality should have Virginia Power agree to this in writing AT THE SAME TIME that the locality executes the new agreement. If it is not in the locality's interest to have the agreement remain in place, then the locality should do nothing and simply sign the new agreement.

15. Total of Savings

While not all changes and benefits in the new contract can be quantified, we estimate that the quantifiable benefits achieved in the new seven-year contract provide savings to the local governments on the order of $6 million on average each year and in excess of $40 million over the life of the seven-year agreement. Further, the negotiations were successful in capping base rates for seven years at prior levels even though Virginia Power maintained that it could support an increase of $11 million per year. Attached to this memorandum is a spreadsheet providing a rough idea of how each local government's share of the $40 million savings compares to its total assessment. (Note: the total assessment is not limited to negotiation services provided by the Steering Committee; it also covers educational, legislative tracking, and competitive procurement services.)

Conclusion

Your counsel and consultants are pleased to have concluded the negotiations and achieved this final contract form. We hope that the Steering Committee's members and all affected local governments are pleased with the result. Please contact us if you should have any questions regarding the new contract or this memorandum.

cc: Mr. Steve Ruback
Mr. Jim Cotton

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